

Chapter 14
Insurance Requirements

14.1

Introduction

This chapter provides the Office of Residential Care Facilities' (ORCF), overall policy with respect to the various types of insurance required in connection with the Section 232 Office of Residential Care Facilities program. Professional Liability Insurance (PLI) required of Healthcare Facilities was formerly addressed by Housing Notice 04-15. PLI is a requirement in a Section 232 project, but it is sufficiently distinct from the other types of required insurance. It is addressed separately in Appendix 14.1 to this chapter.

A. General Insurance Requirements – Applies to All Policies. ORCF requires each Property to be covered by property and liability insurance for the life of the mortgage loan. The named insured for each policy must be the responsible party for that type of insurance policy.

B. All policies must:

1. Be written on a per occurrence basis except for earthquake and professional liability coverage, which may be written on a per claims/claims made basis;
2. Have a cancellation provision requiring the carrier to notify the Lender at least 30 days in advance of any policy reduction or cancellation for any reason except non-payment of premium;
3. Include a cancellation provision that provides for at least a 10-day written notification for non-payment of premium; and
4. Contain a mortgagee clause and loss payable clause acceptable to HUD

C. Policy Requirements:

1. Each policy must either have a term of at least one year at the time of closing the mortgage loan; or
2. Have a term with less than 12 months remaining at the time of closing the Mortgage Loan, so long as the policy contains the required coverage or the required coverage is being added to the existing policy. The Lender must collect funds at Closing and during the months

following Closing to ensure adequate funds will be on deposit with the Lender to pay the next premium by its scheduled due date.

D. Financing of Premiums:

All premiums covering the first full year for existing or new property insurance policies must be paid in full at Closing. Premiums for General Liability and Professional Liability policies may be paid through an alternative payment plan (e.g., monthly or quarterly) approved in writing by the Lender and the insuring entity. The Borrower shall not finance premiums for renewals of any policy covering the physical damage to collateral of the loan.

E. Evidence of Insurance:

The Borrower must provide to the Lender evidence of insurance for the Property on or before the date of Closing or the policy's renewal date. Evidence of insurance coverage for the Property must be provided as follows:

1. Temporary Evidence: Either (i) an ACORD 28 (either the 2003 or 2006 version is acceptable), combined with ACORD 25S, or (ii) ACORD 75S, are acceptable forms of temporary evidence of insurance. If an ACORD certificate is not available, HUD will accept a letter signed by the Borrower and the licensed insurance broker certifying that the coverages, deductibles and exclusions meet HUD's requirements. Temporary coverage, such as an insurance binder, has an expiration date that must be monitored by the Lender and renewed on or before its expiration date. The Lender will be liable to HUD if a binder expires, the Borrower has not provided sufficient evidence of permanent coverage, and an uninsured loss occurs.
2. Permanent Evidence: The originals or certified copies of current insurance policies must be received, reviewed and placed in the Lender's Servicing File within 90 days after the delivery of the Mortgage Loan or the date of the insurance policy renewal. Except for a National Flood Insurance Program (NFIP) policy, only the complete insurance policy is sufficient evidence of coverage. Insurance policy declarations pages, single policy endorsements, insurance binders and certificates of insurance are not an acceptable form of permanent insurance coverage. The Policy Declaration page of a NFIP policy is acceptable evidence of flood insurance coverage.

14.2

Blanket Policies

Use of a blanket or package policy (or policies) of insurance covering the property and other properties and liabilities of the Borrower is acceptable, provided that:

- A. The policy provides the same or better insurance coverage as a single property insurance policy;

- B. The property is listed and identifiable in the policy or associated schedules; and
- C. The policy complies with all other applicable requirements contained in this Chapter.

14.3

Property/Casualty Insurance Carriers

A property/casualty insurance carrier must meet the following rating requirements even if it is rated by one or more rating agencies or conditions:

- A. A.M. Best Company general policyholder's rating of "A-" or better and a financial performance index rating of VI or better in Best's Insurance Reports or Best's Key Rating Guide.
- B. Financial Stability Rating of "A" or better from Demotech.
- C. Various state-wide pools (if it is the only coverage that can be obtained) or flood companies approved under the National Flood Insurance Program (NFIP). Carrier must be licensed to do business in the United States.

14.4

Insurance Data Requirements

- A. **The Lender must retain information of the insurance coverage on each Mortgage Loan for transmittal to HUD upon request.** Information of the following types of insurance is required for each Mortgage Loan:
 - 1. Special Form (Formerly referred to as "All-Risk")
 - 2. Business Income
 - 3. Earthquake
 - 4. Flood
 - 5. Ordinance & Law
 - 6. Windstorm
 - 7. General Liability
 - 8. Umbrella/Excess Liability
 - 9. Professional Liability

B. For each type of insurance listed above, the Lender is required to retain the following data, at a minimum:

1. Name of Insurer
2. Coverage Amount
3. Deductible
4. Expiration Date

HUD requires the Property, Borrower, Operator, and Management Agent shall be covered by the insurances described in this Program Guidance, as appropriate, for the life of the Mortgage Loan. It is the Lender's responsibility to ensure that the insurance requirements are met on an annual basis.

14.5

Property Insurance Requirements

This section covers the requirements that policies for property insurance must satisfy.

A. Property Damage ("Special Form")

What's Required	"Special Form" (formerly referred to as "All Risk") Property Insurance
When Does it Apply?	All property types.
Amount of Coverage	<ul style="list-style-type: none">• 90% of Estimated Replacement Cost. No co-insurance or agreed amount endorsement.
Maximum Deductible	<ul style="list-style-type: none">• \$25,000 per occurrence for a portfolio or single asset Mortgage Loan with a Property having less than or equal to \$100 million in total replacement values, as listed in the policy.• 1% or \$250,000 per occurrence for a portfolio or single asset Mortgage Loans with a Property having greater than or equal to \$100 million in total replacement values, as listed in the policy.

1. The 90% of Estimated Replacement Cost Value (as defined by the Insurable Value Calculation contained in the 3rd party Project Capital Needs Assessment) includes the cost of excavations, foundations, piers, or other supports which are below the surface of the lowest basement floor or where there is no basement, which are below the surface of the ground, underground flues, pipes, and drains. These items are generally excluded from the Property Insurance coverage when it is subject to the provisions of the Coinsurance Clause or similar clause. If the Builders Risk Insurance or the Permanent Fire and Extended Coverage Insurance does not insure

these items, then an amount acceptable to the Mortgagee will be deducted from the Assistant Secretary for Housing-Federal Housing Commissioner's estimate of the 90% of Estimated Replacement Cost for the purpose of estimating the amount of Builders Risk Insurance or the amount of Permanent Insurance.

2. The following exclusions from "Special Form" insurance policies are acceptable:
 - a. War or Military Action,
 - b. Nuclear Hazard,
 - c. Volcanic eruptions,
 - d. Fraudulent or dishonest acts committed by the insured,
 - e. Dispersal, release or escape of contaminants, or pollution (biological and chemical agents), Windstorm, flood and earth movement exclusions also are acceptable, provided a separate policy or coverage is obtained for these exclusions, as specified elsewhere in this chapter.

B. Ordinance and Law Coverage

What's Required	Ordinance and Law Coverage
When Does it Apply?	Properties that contain any type of non-conformance under current building, zoning, or land use laws or ordinances.
Amount of Coverage	<ul style="list-style-type: none"> • <u>Coverage A</u> - Loss of Undamaged Portion of the Property: Equal to 100% of the full replacement cost of the Property less the damage threshold of the local building ordinance. If threshold is not available, 100% of the full replacement cost of the Property. • <u>Coverage B</u> - Demolition Cost: Minimum 10% of the full replacement cost of the Property. • <u>Coverage C</u> - Increased Cost of Construction: Minimum 10% of the full replacement cost of the Property.

C. Boiler and Machinery/Equipment Breakdown Insurance

What's Required	Coverage from loss arising from the operation of pressure, mechanical, and electrical equipment.
When Does it Apply?	Properties where any centralized HVAC, boiler, water heater or other type of pressure-fired vessel is in operation and regulated by the state where the Property is located. If boiler or boilers located at the subject property are other than steam boilers, specific Boiler Explosion Insurance generally is not required. If there is a steam boiler or boilers in operation in connection with the subject property, specific Boiler Explosion Insurance is required.
Amount of Coverage	At least 90% replacement cost (as described in Section 14.A.1) of the building(s) that house the equipment. No co-insurance or agreed endorsement.
Maximum Deductible	No more than the deductibles on the property insurance policy.

14.6

Liability Insurance

- A. **HUD requires that each Property and Borrower be covered by Liability Insurance for the life of the Mortgage Loan.** This section covers the guidelines and requirements that policies for Liability Insurance must meet.
- B. **In the case of new construction, substantial rehabilitation, or additions, both the General Contractor and the Borrower must be covered by Commercial General Liability Insurance.** Such Commercial General Liability Insurance shall be endorsed to include Owner's and Contractor's protective coverage.
- C. **Commercial General Liability Insurance**
1. Commercial General Liability Insurance for bodily injury, property damage and personal injury.
 2. Applies to all property types
 3. Minimum Coverage
 - a. Primary coverage amount: \$1 million per occurrence/\$3 million minimum general aggregate limit, plus
 - b. Minimum Umbrella Liability Insurance (above the primary) is required for 10 or more facilities for an additional \$5,000,000.
 - c. The minimum required coverage limit shall be satisfied by adding any combination of primary and umbrella/excess per occurrence and aggregate limits so that the sum of both equals the sum of the limits required in a. plus b. above
 - d. Use of Blanket Policies must comply with the requirements of this Program Guidance.
 4. Commercial General Liability Insurance Maximum Deductibles:
 - a. \$25,000 deductible/SIR (self-insured retention) for portfolio and/or single asset Mortgage Loans with Properties less than or equal to \$100 million in total replacement values, as listed in the Property policy
 - b. \$100,000 deductible/SIR for portfolios and/or single asset Mortgage Loans with Properties greater than or equal to \$100 million in total replacement values, as listed in the Property policy.

D. **Professional Liability Insurance – refer to Appendix 14.1**

What's Required	Professional Liability Insurance
When Does it Apply?	All properties.
Amount of Coverage	Minimum of \$1 million per occurrence / \$3 million aggregate. Determination of coverage must comply with Appendix 14.1.

Maximum Deductible	Refer to Appendix 14.1
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E. Directors' and Officers' Liability Insurance

What's Required	Directors' and Officers' Liability Insurance
When Does it Apply?	Cooperative Corporations Only.
Amount of Coverage	Minimum \$1 million per occurrence.
Maximum Deductible	Same as required for Commercial General Liability insurance.

F. Commercial Auto Liability Insurance

What's Required	Commercial Auto Liability Insurance that covers owned, non-owned, hired and leased vehicles (whichever shall apply), including personal injury protection and uninsured motorist liability.
When Does it Apply?	If the Property uses cars, vans or trucks for business purposes, Commercial Auto Liability Insurance must cover those vehicles. This also applies during the construction period.
Amount of Coverage	\$1 million per occurrence.

14.7

Additional Insurances

The following sections specify additional insurance coverage required by HUD for each Property.

A. Business Income Coverage

What's Required	Business Income Coverage is required for all property insurance coverage including windstorm, flood and earthquake, even if written on a stand-alone basis. See Windstorm Coverage, for additional information regarding the windstorm.
When Does it Apply?	All property types.
Amount of Coverage	<ul style="list-style-type: none"> Actual loss sustained or minimum of most recent 12 months' net revenue plus ongoing expenses. 180-Day Extended Period of Indemnity. Provides an additional 180 days of business income or rent loss coverage if, after the damaged Property is ready for occupancy and is occupied, the occupancy level of the Property is lower than it was immediately before the Property was damaged.
Maximum Deductible	Two weeks per occurrence.

B. Earthquake

What's Required	Earthquake Insurance
When Does it Apply?	<p>Earthquake Insurance is required for all properties located in Seismic Zones 3 or 4 that meet the Property risk factors listed below:</p> <ul style="list-style-type: none"> • Properties located in Seismic Zones 3 or 4: <ul style="list-style-type: none"> ○ reinforced masonry buildings and pre-cast concrete or tilt-up buildings constructed prior to 1994; ○ reinforced concrete frame or reinforced concrete shear wall buildings constructed prior to 1976; ○ wood frame buildings on non-braced cripple walls (sometimes referred to as crawl space walls – short wood perimeter walls used to elevate a Property above-ground to allow access to the substructure and utility lines or to level a building constructed on a slope); ○ wood frame buildings without anchorage to foundation; or, ○ any building with a weak (soft) story at the first level above grade. • Properties located in Seismic Zone 4 only: <ul style="list-style-type: none"> ○ buildings on sites with significant liquefaction potential (e.g., low-lying areas along bodies of water such as rivers, lakes, bays, the coast or waterways) unless provided with deep foundations (piles or piers); or, ○ buildings with tuck-under parking constructed prior to 1988. • PML Study <p>A level I, Seismic Risk Assessment (Probable Maximum Loss [PML] Study) is required for any Mortgage Loan:</p> <ul style="list-style-type: none"> ▪ greater than \$25 million, or ▪ secured by a Property having one or more of the above risk factors. <p>The PML study will be performed by the engineer performing the PNA so long as such engineer is also qualified to perform geological assessments.</p> <p><u>Acceptable Level of Seismic Risk</u></p> <p>The acceptable level of seismic risk is represented by a Probable Maximum Loss (PML), using a 10%/50 year exceedance probability, which does not exceed 20%. If the Property has a PML that exceeds 20%, but is less than 40% (using the 10%/50-year exceedance probability standard), a waiver will be required.</p> <p><u>Ineligible Properties</u></p> <p>A Mortgage Loan secured by a Property in Seismic Zones 3</p>

	<p>or 4, and having one or more of the following risk factors is not eligible for mortgage insurance:</p> <ul style="list-style-type: none"> ▪ unreinforced masonry buildings; ▪ buildings constructed on hillsides with slope exceeding a 30 degree angle; and ▪ a PML greater than 40%, using the 10%/50-year exceedance probability standard.
Amount of Coverage	<ul style="list-style-type: none"> • 100% of the full replacement cost of the Property Improvements. • Business income coverage for a minimum of 12 months plus a 180- day extended period of indemnity (as otherwise specified in this Program Guidance). Business Income coverage is required even if written on a stand-alone basis.
Maximum Deductible	10% of the total insured value as listed on the policy, maximum \$250,000 per location.

C. Builder's Risk Insurance

What's Required	<p>Builder's Risk Insurance (comprehensive form). The Builders Risk Insurance policy or policies shall show the Borrower as the Insured and shall also show as additional insured the general contractor and other contractors and subcontractors, as their interests will appear.</p>
When Does it Apply?	All property types during construction or substantial rehabilitation.
Amount of Coverage	100% of the completed value, on a non-reporting basis.
Maximum Deductible	\$25,000 per property.

D. Workers' Compensation

What's Required	Statutory Workers' Compensation and Employer's Liability Insurance
When Does it Apply?	Where employees of the Borrower are required to be covered by workers' compensation laws of the state where the Property is located.
Amount of Coverage	<ul style="list-style-type: none"> • Employer's Liability with a limit of \$1 million; and, • Statutory Limits for compensation.

E. Fidelity Bond/Crime Insurance

What's Required	<p>Fidelity Bond, Employee Dishonesty coverage or Crime Insurance. This insurance reimburses the insured for losses resulting from dishonest acts of any employee, officer or board member. The policy must cover:</p> <ul style="list-style-type: none">• All principals of the management entity, and• All persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts, and records. <p>Coverage shall be through one or more bonds, and one bond may cover more than one project, including projects whose mortgages are not insured or held by HUD. The agent's principals and supervisory and front-line staff will be covered under the same bond.</p>
When Does it Apply?	All properties.
Amount of Coverage	<ul style="list-style-type: none">• 2 months of Gross Potential Income of project• If coverage is for more than one project, the minimum is computed using the project with the highest gross potential income.
Maximum Deductible	\$25,000 per property.

F. Sinkhole/Mine Subsidence Insurance

What's Required	Sinkhole/Mine Subsidence Insurance
When Does it Apply?	All properties in areas prone to these geological phenomena.
Amount of Coverage	100% replacement cost.
Maximum Deductible	\$25,000 per property.

G. Windstorm Coverage

What's Required	<p>If the "Special Form" property damage insurance excludes any type of wind-related event, a separate windstorm insurance policy must be obtained.</p> <p>Coverage obtained through state insurance plans or other state-managed windstorm and beach erosion insurance pools is acceptable if that is the only windstorm coverage available in an insurance market.</p>
When Does it Apply?	All properties.
Amount of Coverage	<p>100% replacement cost or, if replacement cost coverage is not available, the then actual cash value of the Property if it equals or exceeds the current unpaid Mortgage Loan balance.</p> <p>Business income: Actual loss sustained or minimum most recent 12 months net revenue plus ongoing expenses. Business Income coverage is required even if written on a stand-alone basis</p>

Maximum Deductible	<p>10% of the total insured value, as listed on the policy, maximum up to \$250,000 per occurrence.</p> <p>*Business Income should not be subject to a deductible or waiting period greater than two weeks.</p>
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H. Flood Insurance

1. The Lender must determine, for every insured mortgage, whether any of the improvements are located in a Special Flood Hazard Area (SFHA). SFHAs are areas designated by the Federal Emergency Management Agency (FEMA) as Zone A or V. An application for mortgage insurance shall not be approved for a property located in a FEMA identified special flood hazard area in which the community has been suspended from or does not participate in the National Flood Insurance Program.

What's Required	Flood
When Does it Apply?	<p>Flood insurance is required for any building fully or partially located in SFHA, Zone A or V. Even if that part of the building within the SFHA is not subject to coverage (e.g., a deck), the entire building is considered to be in the SFHA.</p> <p>If no part of a building is located in an SFHA, then flood insurance is not required, even if the unimproved portions of the Property are in an SFHA.</p>
Amount of Coverage	<p>100% of replacement cost of Improvements located in an SFHA.</p> <p>Business income coverage for a minimum of 12 months plus a 180-day extended period of indemnity (as otherwise specified in this Program Guidance) for Improvements located in an SFHA. Business Income coverage is required even if written on a stand-alone basis.</p> <p>If 100% of the full replacement cost is unavailable or the premium cost is commercially unreasonable, then the maximum amount of insurance available under the National Flood Insurance Program (NFIP) must be obtained. An excess flood or Difference In Conditions (DIC) policy must provide for the difference, if any, between the maximum limit provided by NFIP policies and the full replacement cost and the required Business Income coverage as noted above.</p>
Maximum Deductible	2% of the replacement cost of the Mortgaged Property.

- a. Flood insurance must be in the form of the standard policy issued by either a member of the National Flood Insurance Program (NFIP) or a private company authorized to participate in the NFIP's "Write Your Own" program (WYO). Conditions may change over time and zones may be remapped,

resulting in the reclassification of non-flood areas. The Lender must ensure that flood insurance is obtained if any property improvements are later determined to lie within a remapped SFHA.

- b. If conditions warrant, HUD or the Lender will require flood insurance for Property Improvements located outside of an SFHA but within an area designated by FEMA as Zone X, such as a Property that is in an area subject to flooding due to storm water or within close proximity to an SFHA boundary.
2. Flood Insurance Determination: For every Mortgage Loan, the Lender must *determine whether any of the Property Improvements are located in an SFHA and must document each determination on a Standard Flood Hazard Determination form issued by FEMA (FEMA Form 81-93). The Lender must obtain flood-zone determinations from a qualified third-party flood-zone determination firm. The Lender must place a completed copy of the Standard Flood Hazard Determination form in the Lender Servicing File for the Mortgage Loan. HUD expects the Lender to exercise care and sound judgment when it selects and contracts with a third-party flood-zone determination firm.*

Because conditions may change over time, the status of a zone may change. As a result, the Lender must obtain from its flood zone determination firm "life-of-loan" monitoring and coverage, which means that the monitoring company will notify the Lender if and when flood insurance is required for a monitored Property. The Lender must ensure that the monitoring company it selects agrees to continue monitoring for all of the covered Properties in the event that the Lender sells or otherwise transfers its servicing rights to another Mortgage Loan servicer.

3. The flood insurance policy must be issued by either a member of the National Flood Insurance Program (NFIP) or a private company authorized to participate in the NFIP's "Write Your Own" (WYO) program.

List of FIP WYO insurers: http://www.fema.gov/business/nfip/wyo_subsidaries.shtm

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